

Bankruptcy Process

Student's Name

Institutional Affiliation

### Bankruptcy Process

Bankruptcy is a legal state of an entity that occurs when the entity is unable to repay dues owed to its creditors. This is more often mistaken with insolvency, which refers to the financial status of an individual or company as opposed to the legal status (Larsen, 2000). An entity stands for a legal person who can be a sole proprietor, a firm or any organization. Two different parties are involved in the bankruptcy process. These are the debtor, who is the owner of the business, and the creditor whose dues are owed by the debtor. The term individual is used to refer to a natural person or in business terms, the sole proprietor.

There are four types of bankruptcy that can be filed when one's business is not able to meet its obligations as, and when, they fall and these are promulgated in the United States Bankruptcy code. The first type is a liquidation bankruptcy found in Chapter seven and is what many people confuse for bankruptcy (Elias, Renauer and Leonard, 2008). In this scenario, the person entrusted with the bankruptcy realizes the assets held by the debtor in order to settle the existing business obligations. All the forms of business ownerships including corporations, partnerships and sole ownerships are eligible to file for this bankruptcy. After paying off the obligations of the business, the balance is discharged. However, most forms of business ownerships are against this form of bankruptcy since it becomes difficult to continue carrying on business operations and the debtor loses ownership and control of the assets.

The second type of bankruptcy found in chapter eleven is where the bankrupt party continues in business and comes up with a plan to settle the existing business financial obligations. This is the most complicated bankruptcy filing filed majorly by troubled businesses. However in order to curb the abuses of this form, if the debtor does not come up with plan within reasonable time, the creditor is allowed to give his own plan.

In the third type under chapter twelve, owners of firms are considered, in that, the debtor is allowed to continue operating his business and comes up with a plan for settling his obligations. Last but not least, chapter thirteen is a bankruptcy form that addresses individuals only, where the ownership and use of assets is retained by the debtor who comes up with a 3 to 5 years plan to settle the existing debt.

The client can file for this chapter seven of bankruptcy since it is reserved for all forms of business ownerships which include corporations, individuals and partnerships. However, he must contend with the fact that he is legally barred from business operations and both ownership and control of his assets. The client can also file for chapter eleven bankruptcy since it expressly covers corporations although allows individuals to some extent. Nonetheless, the debtor must note that this is a complicated form and mostly filed by troubled businesses. It is however advantageous since the debtor is allowed to continue with operations and even retain ownership and control of assets. The client will not be allowed to file for chapter thirteen bankruptcy since it is purely reserved for individuals only.

Filing for bankruptcy entails various benefits. Most of the debt is written off from your accounts in consideration of your peace of mind and freedom so that you can focus on the payment plan. Most cases are discharged after twelve months and you can keep your tools of work if self employed. The process is not as adverse as thought of by the general public coupled with the fact that, media publications are not read entirely by everybody nor noticed. There are several disadvantages associated with bankruptcy. Your prestigious assets including your house can be sold off and certain obligations (debts) are not written off like student loan repayment and legal fines. In case of an Initial Public Offering being imposed, a portion of your surplus will be used to meet your obligations for a period of three years. Restrictions in the form of limits are imposed on obtaining credit especially use of credit cards and further loans. You can lose your job especially if you are a civil servant or work in a financial institution, which directly deals with liquid money. Bankruptcy state can't allow one to either form a company or be eligible for company directorship. You will need six years in order to be given a clean bill of health so that you can once again access ordinary credit facilities like loans and mortgages. This state can lead to social stigma since your bankruptcy status is published in the national press (Swanson, Marshall, Lyndon and Norley, 2008).

Had the clients business been a partnership, chapter seven would be the most applicable solution since chapter eleven is mostly used by corporations. This would mean that the partnership discontinue operations and cease ownership and control, of its assets. In my opinion, the client should file for bankruptcy since its benefits outweigh

its drawbacks. Having a debt of \$2.9 million in the balance sheet which is due for payment has financial implications on the organization and therefore if not cleared it might even be difficult for the company to acquire extra finance to finance both short term and long term capital requirements. In addition to the above deliberations, the company's benefits from the process will be material. For instance, major creditors would be written off from the balance sheet and only non exempt assets would be discharged.

The client should go for chapter eleven because it allows the owners to continue operations provided they come up with a plan of repaying the creditors and other financial obligations and commitments amounting to \$2.9 million in this scenario. Most importantly, the client will still retain the ownership and control of his assets. This will give the client the opportunity to use the assets in generating income for the settlement of the said financial obligations and commitments being demanded in the form of creditors.

In conclusion, bankruptcy process can be undertaken by individual natural persons, sole proprietors, partnerships and companies. It is also critical to note that bankruptcy and insolvency are completely different matters. Insolvency refers to a financial condition of a person or business whilst bankruptcy denotes a legal state. Moreover, when undertaking the bankruptcy process, the order of payment to creditors should start from preferential creditors like government taxes, followed by secured creditors, non secured creditors, preferential shareholders then lastly ordinary shareholders.

### References

Elias, S., Renauer, A. and Leonard, R. (2008). *How to File for Chapter 7 Bankruptcy* (15<sup>th</sup> ed.). New York. NY: Nolo.

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